FORTIS BANK COMMENTS ON BASEL COMMITTEE CP3

KEY ISSUES - SUMMARY

1. REQUIRED CAPITAL AT CONSOLIDATED LEVEL

- The required regulatory capital is the one computed at the top consolidated bank level.
- Calculation at sub-consolidated or individual level should be no more than flexible incidental verifications
- Consolidated required regulatory capital is allocated top-down to the subsidiaries.
  The home supervisory authority, in accordance with the host supervisors will control the suitable breakdown of capital between the entities of the group according to their individual risk exposure.
- Home supervisor has the final say on the consolidated required capital and the top-down breakdown.

2. PILLAR 1 – EXPECTED LOSS & UNEXPECTED LOSS – PROVISIONS

- Triangular (Basel Committee, IASB, and Banking industry) co-ordination should ensure the consistency between regulatory and accountancy rules for the definition of capital, of expected and unexpected losses (EL + UL) and for the handling of provisions.

3. PILLAR 1 – CALIBRATION

- Calibration should remain open. A further calibration should be carried out before implementation in 2006.
  Basel Committee should accept a QIS 4 in 2005, if demanded by a majority of concerned banks
- Eligibility durations should be reviewed with the banking industry and put in line with the current banking practices.
  For instance, the eligibility duration for short-term self-liquidating trade letters of credit should be maximum 12 months

4. PILLAR 1 - ROLL-OUT OF AIRBA – TEMPORARY SIMULTANEOUS USE OF AIRBA AND CURRENT

- Banks which are committed to fully implement AIRBA within a reasonable time and which have a change-over plan agreed with the home supervisor, should be allowed (but not obliged) to keep the current Basel I Accord beyond 2006 for those portfolios not yet in AIRBA.
- AIRBA banks should be allowed to continue to use the current Basel I Accord or use an equivalent simplified Standardised Approach for the non-material portfolios.

5. PILLAR 1 - ROLL-OUT OF AIRBA - TEMPORARY FLEXIBILITY FOR SOME ELIGIBILITY CRITERIA

- Banks which are committed to fully implement AIRBA within a reasonable time and which have a change-over plan agreed with the home supervisor, should be recognised as being in AIRBA for those portfolios where the AIRBA is fully implemented within the bank and embedded in the current operations and process of the bank, without waiting that the 3 years for use of models and 7 years for historical data are elapsed.
  The regulatory minimum capital will be that required under AIRBA. Possible adjustments asked by supervisor will occur only under Pillar II.

6. PILLAR 1 - QUALIFYING REVOLVING RETAIL EXPOSURES – QRRE

- Best solution should be to drop QRRE in order to avoid competitive distortions with similar products.
- At least, QRRE should be redefined by focusing on its essential feature of “very high future margin income”. The background (revolving credit cards) and its product features (revolving, uncommitted and unsecured) should be completely removed.

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7. **PILLAR 1 - INSURANCE CAPTIVES**
Captives, which are placed under the bank, should be recognised as risk mitigation instrument, subject to the bank proving to his (home) national supervisor that the capital is specially dedicated to mitigate unexpected risks (credit as operational risks) and that the coverage is adequate.

8. **PILLAR 1 – OPERATIONAL RISKS – AMA – FLEXIBILITY**
Banks should not be restrained by overprescriptive rules to evolve towards a more efficient risk management and a better risk mitigation
   - Banks should be allowed to use conservative, expert-based correlation ratios, which have to be tested and adjusted over time.
   - Instruments other than insurance should be allowed for risk mitigation.
   - Banks should be allowed to apply a threshold for operational risk as part of a credit event (for instance above 1 million EUR credit loss)

9. **LIMITED NATIONAL DISCRETION**
   - The Accord Implementation Group (AIG) should have the fundamental responsibility in ensuring uniform, consistent and transparent interpretation of the Basel Accord.
     The AIG should also have the responsibility to reach supplementary agreements to reduce progressively the national discretion.

10. **CO-ORDINATION BETWEEN SUPERVISORS - HOME / HOST PRINCIPLE**
   - In the text of Pillar 2 "Key principles of supervisory review" should be added a "Principle 5" specifying the roles of home / host supervisors and the principle of mutual recognition. The text should also describe the respective responsibilities of the home and the host supervisors and the way of mutual recognition.
   - The to-be-published sound practices paper for supervisors should be part of the Basel Accord (probably as a separate document).
   - To enhance co-operation, it should be allowed to create, if the situation requires it, a "College of supervisors" for each major cross-border banking group in order to streamline the valuation processes as well as the compliance process without contravening the legitimate and necessary needs of host supervisors regarding subsidiaries within their jurisdictions.

11. **PILLAR 2 - ASSESSMENT OF OWN CAPITAL NEEDS V. ADD-ONS**
   - Pillar 2 chapter "Specific issues to be addressed under the supervisory review" should either be dropped either completely rewritten & reintegrated in Pillar 1.
     Pillar 2 should keep its initial objective: the bank assesses its own capital needs and the supervisor reviews it.
     Supervisors should not create industry-wide add-ons or additional buffers via Pillar 2
   - The assessment by an individual bank of its own capital needs should be a net adjustment. Pillar 2 should not simply sum the areas of capital deficiency and disregard the areas of capital surplus.

12. **PILLAR 3 - CONSISTENCY BETWEEN IAS AND BASEL**
   - Basel definitions should be strictly harmonised and consistent with accountancy / IAS definitions.

13. **MARKET DISCIPLINE TO COMPLEMENT MINIMUM CAPITAL REQUIREMENTS**
   - Mandatory disclosures are only at top consolidated level.
   - Banks should not have to disclose under Pillar 3 the supervisory review process or the conclusions made by supervisors for an individual bank.
   - Banks should have to disclose neither the assessment on its own capital nor the review (and possibly imposed add-ons) by the supervisor under Pillar 2.

14. **PILLAR 3 - DISCLOSURES**
Technical information remains excessive. Some examples are:
   - Disclosures about PD, LGD, EAD and about back testing.
   - Disclosures about insurance are inconsistent (deducted following Pillar 1)
   - Disclosures of the capital under BIA and STA when a bank has adopted AMA.

FORTIS BANK

FORTIS BANK COMMENTS ON BASEL COMMITTEE CP3
KEY ISSUES

A. INTRODUCTION

- Fortis Bank is a cross-border bank with the Benelux countries as its home market. It is the largest Belgian bank and the third largest provider of financial services in the Benelux.
  Fortis bank intends to adopt from 2006 AMA for operational risks. It will start in 2006 with a mix of FIRBA & AIRBA for credit risks and progressively evolve towards full AIRBA.
- The proposed New Basel accord, as expressed in the Third Consultative Paper, is fully supported by Fortis Bank concerning its principles and goals.
  Nevertheless, some major concerns, not only for Fortis Bank but also for other banks are still not met.
- The document "Fortis Bank comments on Basel Committee CP3 – Key issues " lists the key issues and proposes for each issue a solution.
  The document "Fortis Bank comments on Basel Committee CP3 – Summary" is a genuine extract of the "Key issues" document, highlighting the main proposed changes.
  If required, Fortis Bank is ready to make available supporting documents and to further discuss the issues with the Basel Committee.
- **Contact** :

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B. SCOPE OF APPLICATION

1. REQUIRED CAPITAL AT CONSOLIDATED LEVEL

Issue:

- The basic principle [1] is that the Basel Accord will be applied on a consolidated basis. But this principle is weakened by the restrictions "apply at every tier within a group at a consolidated basis" and by " adequately capitalised on a stand-alone basis" [2]
- The consequences of those restrictions are that international active banks or cross-border banks will have to follow, in each country, the requirements of the (host) national supervisor and that the sum of the regulatory capital required at sub-consolidation or stand-alone level exceeds the regulatory capital computed for the top consolidated bank.
  Cross-border banks with several home markets (small countries) will be in an unfavourable position in comparison with banks with a single home market (large countries)
- Particularly but not only for operational risks, sub-consolidated or stand-alone levels are inadequate for an efficient risk management: insufficient data, benchmarks, etc.

Fortis Bank standpoint:

- The required regulatory capital is the one computed at the top consolidated bank level.
- Calculation at sub-consolidated or individual level should be no more than flexible incidental verifications
- Consolidated required regulatory capital is allocated top-down to the subsidiaries.
  The home supervisory authority, in accordance with the host supervisors will control the suitable breakdown of capital between the entities of the group according to their individual risk exposure.
- Home supervisor has the final say on the consolidated required capital and the top-down breakdown.

C. PILLAR I

2. PILLAR 1 – EXPECTED LOSS & UNEXPECTED LOSS - PROVISIONS

Issue:

- In the QIS 3 simulation, the calibration covers both expected loss (EL) and unexpected loss (UL). It means that the capital (numerator) covers EL and UL. Consequently, the capital has to include all the provisions (general provisions and specific provisions), constituted to cover the expected losses (EL).
- An alternative approach could be that the capital covers only the UL. All the provisions will be excluded from the capital; calibration has to be reviewed downwards to focus on UL only.
  This approach seems more in line with IAS.

Fortis Bank standpoint:

- Triangular (Basel Committee, IASB, and Banking industry) co-ordination should ensure the consistency between regulatory and accountancy rules for the definition of capital, of expected and unexpected losses (EL + UL) and for the handling of provisions.

3. PILLAR 1 - CALIBRATION

Issue:

- Calibration resulting of the QIS 3 seems insufficiently consistent through the approaches and the business segments. Some elements of explanation are: certain banks still use a definition of default near to recovery; Unavailable or insufficiently reliable data are replaced by shortcuts or so-called expert-based figures; Models are not yet implemented or back-tested.
  The regulatory LGD's in FIRBA, particularly the main LGD of 45%, apparently does not reflect

[1] CP 3 - § 1
[2] CP 3 - § 3-4

the risk profile of the certain banks.
Equity exposures and securitisation are too conservatively treated and the required capital is penalising.
For operational risks, there is no incentive to move from BIA to STA, as Alpha (15%) is equivalent to the average Beta.

- CP3 specifies a lot of eligibility durations; some are not in line with the bank experience.
  The 3 months maximum for short-term self-liquidating letters of credit [3] is an example of it.
  Fortis Bank is an important player in this field and its experience is that only 58 % in value are effectively liquidated within the 3 months.

		IMPORT	EXPORT CONF	TOTAL
TOTAL	Nb of openings	61,58%	38,42%	100,00%
	Value	48,86%	51,14%	100,00%
Less than 3 months	Nb of openings	48,00%	28,54%	76,53%
	Value	27,38%	30,15%	57,53%
Between 3 & 6 months	Nb of openings	11,93%	7,84%	19,77%
	Value	8,45%	11,98%	20,43%
Between 6 & 12 months	Nb of openings	1,26%	1,76%	3,02%
	Value	3,30%	5,64%	8,94%
Over 12 months	Nb of openings	0,38%	0,29%	0,67%
	Value	9,73%	3,37%	13,10%

Fortis Bank standpoint:

- Calibration should remain open. A further calibration should be carried out before implementation in 2006.
  Basel Committee should accept a QIS 4 in 2005, if demanded by a majority of concerned banks
- Eligibility durations should be reviewed with the banking industry and put in line with the current banking practices.
  For instance, the eligibility duration for short-term self-liquidating trade letters of credit should be maximum 12 months

4. PILLAR 1 - ROLL-OUT OF AIRBA – TEMPORARY SIMULTANEOUS USE OF AIRBA AND CURRENT

Issue:

- The US supervisor, Federal Reserve, will enforce only the AIRBA and AMA approaches and impose it to the 10 top US banks. Some 5 to 15 other US banks should apply AIRBA & AMA on a voluntary basis. All other US banks will remain in the current Basel I plus.
  Non US banks operating in the States could have to be in AIRBA / AMA, at least for their US operations.
  As the Basel Accord will not be definitive before end 2003 and as the Basel Accord imposes eligibility criteria for AIRBA/AMA, it could be that some US banks will not be fully ready end 2006 and continue to apply the current Basel I, at least for part of their portfolios.
- US banks will probably continue to use the current Basel I Accord for non-material portfolios.
  European banks will be obliged to implement a new (costly) approach (STA), possibly only for unmaterial portfolios.
- Belgian and Dutch supervisors (CBF & DNB) recommend strongly to their major banks FIRBA as a minimum and AIRBA as final target.
  Fortis Bank, as other Belgian and Dutch major banks, has AIRBA as final target.
  As the regulatory framework is still not definitive, Fortis Bank, as many other banks, needs a changeover period, well beyond 2006, to evolve progressively towards AIRBA.
- FIRBA is felt as unattractive: The regulatory LGD's are too high and don't reflect the risk profile of Belgian banks; The credit risk mitigation covers only part of the currently used collaterals and handling is over-prescriptive and cumbersome; The incentive in terms of reduced regulatory capital is insufficient (and for some even negative).

[3] CP 3 - § 58 & 284

- Implementation of the Basel Accord requires huge investments. Fortis Bank wants to optimise its investments (convergence between business needs such as economic capital & pricing and regulatory requirements; embedding of Basel requirements in automated and cost-effective processes; etc.) and to avoid investing in temporary systems just to meet regulatory requirements.

Fortis Bank standpoint:

- Banks which are committed to fully implement AIRBA within a reasonable time and which have a change-over plan agreed with the home supervisor, should be allowed (but not obliged) to keep the current Basel I Accord beyond 2006 for those portfolios not yet in AIRBA.
- AIRBA banks should be allowed to continue to use the current Basel I Accord or use an equivalent simplified Standardised Approach for the non-material portfolios.

5. PILLAR 1 - ROLL-OUT OF AIRBA - TEMPORARY FLEXIBILITY FOR SOME ELIGIBILITY CRITERIA

Issues:

- CP3 grants [4] to banks a much greater flexibility to evolve towards more advanced approaches. It allows the simultaneous use of the several approaches (STA + FIRBA + AIRBA; STA + AMA), subject to agreement of (home) supervisor and to absence of cherry picking.
- CP 3 still maintains [5] a hurdle to a progressive and smooth evolution to AIRBA: The transition starts on the date of implementation of the Basel Accord and is currently available for FIRBA only. As the Basel Accord increases each year from 2006, the requirement with one year, AIRBA becomes, particularly for banks needing a longer changeover period, an unreachable target within a reasonable time.
- The Basel Accord is not yet definitive and the implementation framework imposed by local legislator and supervisor will not be ready before 2005. It means that the eligibility criteria for AIRBA (models minimum 3 years in use, up to 7 years historical data, use tests, etc.) are retroactive.

Fortis Bank standpoint:

- Banks which are committed to fully implement AIRBA within a reasonable time and which have a change-over plan agreed with the home supervisor, should be recognised as being in AIRBA for those portfolios where the AIRBA is fully implemented within the bank and embedded in the current operations and process of the bank, without waiting that the 3 years for use of models and 7 years for historical data are elapsed.
  The regulatory minimum capital will be that required under AIRBA. Possible adjustments asked by supervisor will occur only under Pillar II.

6. PILLAR 1 - QUALIFYING REVOLVING RETAIL EXPOSURES - QRRE

Issue:

- BC adopted a special treatment for Qualifying Revolving Retail Exposures (QRRE), aiming in fact credit cards.
- The newly introduced category of QRRE may be considered as an “over-elaboration” and could lead to competitive distortions: Belgian banks grant consumers credits, which are generally secured by "domiciliation" and assignment of wages and which have to strictly comply with the Belgian legislation aiming to protect consumers. Those consumers credits have a “very high future margin income”, but are committed (calling of credit is regulated by law) and are possibly secured.
  In comparison with self-purpose products granted by credit cards companies, those consumers credits will be charged with a higher regulatory capital requirement, consequently have a higher pricing and suffer of a competitive disadvantage due only to regulatory distortions.

Fortis Bank standpoint:

- Best solution should be to drop QRRE in order to avoid competitive distortions with similar products.

[4] CP 3 - § 225 to 231
[5] CP 3 - § 233-234

- At least, QRRE should be redefined by focusing on its essential feature of "very high future margin income". The background (revolving credit cards) and its product features (revolving, uncommitted and unsecured) should be completely removed.

7. PILLAR 1 - INSURANCE CAPTIVES

Issue:
Insurance captives are deducted from the bank's equity [6] and not recognised as risk mitigation [7] for operational risks. This is a double exclusion.
Insurance captives are used by some banks to set capital aside in view of coping with unexpected losses (low frequency / high impact occurrence of risks).

Banks standpoint:
Captives, which are placed under the bank, should be recognised as risk mitigation instrument, subject to the bank proving to his (home) national supervisor that the capital is specially dedicated to mitigate unexpected risks (credit as operational risks) and that the coverage is adequate.

8. PILLAR 1 – OPERATIONAL RISKS – AMA – FLEXIBILITY

Issue:
The management of operational risks is still a domain in rapid evolution and generally accepted best practices are still to be defined. Therefore, banks have to be creative and overprescriptive rules will restrain a constant improvement in the risk management

- Risk mitigation will not be limited to insurance products. [8] For instance, financial market products will probably be created, which have a return associated to the non-materialisation of operational events.
- Correlation across business lines and loss event types [9] is a major factor of risk management. But the required process is inadequate: a high level of confidence in the correlation factors is required, while such requirement could possibly never be achieved over time due the scarcity of observable data.
- The recording of all operational risk loss as part of a credit event [10] is much too demanding from an operational standpoint.

Fortis Bank standpoint:
Banks should not be restrained by overprescriptive rules to evolve towards a more efficient risk management and a better risk mitigation

- Banks should be allowed to use conservative, expert-based correlation ratios, which have to be tested and adjusted over time.
- Instruments other than insurance should be allowed for risk mitigation.
- Banks should be allowed to apply a threshold for operational risk as part of a credit event (for instance above 1 million EUR credit loss)

D. PILLAR 2

9. LIMITED NATIONAL DISCRETION

Issue:

- CP 3 allows for choices between various options and for flexible interpretation and additional requirements by local supervisors in different countries (national discretion).

Fortis Bank standpoint:

- The Accord Implementation Group (AIG) should have the fundamental responsibility in ensuring uniform, consistent and transparent interpretation of the Basel Accord.
  The AIG should also have the responsibility to reach supplementary agreements to reduce progressively the national discretion.

[6] CP 3 - § 11
[7] CP 3 - § 638
[8] CP 3 - § 637
[9] CP 3 - § 629 (d)
[10] CP 3 - § 633 (5)

10. CO-ORDINATION BETWEEN SUPERVISORS - HOME / HOST PRINCIPLE

Issue:

- In the Overview document [11], co-operation between home and host supervisors, and mutual recognition are highlighted as essential for cross-border implementation. But the CP 3 – Pillar 2 is silent about home-host issues.
- Divergent implementation or interpretation by local (host) supervisors will conduct to contradictory rules to be applied by a single banking group, to heavier investments and running costs, to duplication of reporting and to higher capital requirements. Indeed, it would be difficult for banks to understand a situation where supervisors could agree on common rules and regulations but not on their interpretation and where supervisors are unable to implement the Basel Accord in a consistent way.
- The principle of home / host supervisors and the repartition of their responsibilities, the principle of mutual recognition should be an integral part of the Basel Accord.
- The Home supervisor should act as leader and co-ordinator and should have the prime and overall responsibility for the whole Banking group. The Host supervisor should be in charge of the local supervision under the co-ordination of the Home supervisor.
  The Home supervisor should be in charge of ensuring that the qualitative and quantitative criteria for eligibility for an approach are satisfied, of approving the methodologies, tools, models and processes, and of establishing the validation processes.
  The Home supervisor should also have the final say on the overall required capital.
  The Home supervisor may delegate under its control, part of the reviewing or approving to the Host supervisors

Fortis Bank standpoint:

- In the text of Pillar 2 "Key principles of supervisory review" [12] should be added a "Principle 5" specifying the roles of home / host supervisors and the principle of mutual recognition. The text should also describe the respective responsibilities of the home and the host supervisors and the way of mutual recognition.
- The to-be-published sound practices paper for supervisors should be part of the Basel Accord (probably as a separate document).
- To enhance co-operation, it should be allowed to create, if the situation requires it, a "College of supervisors" for each major cross-border banking group in order to streamline the valuation processes as well as the compliance process without contravening the legitimate and necessary needs of host supervisors regarding subsidiaries within their jurisdictions.

11. PILLAR 2 - ASSESSMENT OF OWN CAPITAL NEEDS V. ADD-ONS

Issue:

- The initial objective of the Supervisory review process was to provide a framework where the responsibility of the bank was to assess its own capital needs and where the supervisor's role was to review and challenge this process and intervene promptly where necessary, including being able to set higher minimum capital standards for an individual bank. This objective was broadly supported by the banking industry.
  It means: The assessment by the bank of its capital needs and the review by the supervisor is a process independent of Pillar 1, but supporting Pillar 1 (cross-checking). If the capital needs assessed under Pillar 2 are lower than the capital requirements under Pillar 1, the minimum capital requirements of Pillar 1 will apply. In the reverse situation, the assessed capital needs under Pillar 2 will be required.
- The CP 3 "Specific issues to be addressed under the supervisory review" [13] creates the concern that Pillar 2 is moving toward a system of automatic capital add-ons on top of Pillar 1, driven by general regulatory requirements. This is in absolute contradiction with the QIS exercise and would dramatically throw the Basel Accord off its balance.
  Pillar 1 is calibrated to generally deliver an adequate regulatory capital charge and will require banks to meet high qualitative and quantitative standards. Additional capital requirements under Pillar 2 should be driven by the specific circumstances of each individual bank.

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[11] Overview § 65 to 67
[12] CP 3 - § 683-718
[13] CP 3 - § 719 to 755

Fortis Bank standpoint:

- Pillar 2 chapter "Specific issues to be addressed under the supervisory review" should either be dropped either completely rewritten & reintegrated in Pillar 1.
  Pillar 2 should keep its initial objective: the bank assesses its own capital needs and the supervisor reviews it.
  Supervisors should not create industry-wide add-ons or additional buffers via Pillar 2
- The assessment by an individual bank of its own capital needs should be a net adjustment. Pillar 2 should not simply sum the areas of capital deficiency and disregard the areas of capital surplus.

E. PILLAR 3

12. PILLAR 3 - CONSISTENCY BETWEEN IAS AND BASEL

Issue:

- The Basel Committee recognises that the Basel disclosure framework should avoid duplication with IAS requirements. Nevertheless, some discrepancies remain.
- Asking explanations about differences with the IAS figures is unconsistent, as disclosures must be produced according to IAS rules.

Fortis Bank standpoint:

- Basel definitions should be strictly harmonised and consistent with accountancy / IAS definitions.

13. MARKET DISCIPLINE TO COMPLEMENT MINIMUM CAPITAL REQUIREMENTS

Issue:

- Pillar 3 is only applicable at the top consolidated level of the banking group. Disclosures related to individual banks within the group would not generally be required (exception for disclosures of Total and Tier 1 ratio) [14].
  The second sentence and particularly the words "not generally" are confusing and should be dropped.
- Confusion should be avoided and clear separation kept between the needs of the supervisors (mandatory confidential disclosures), the needs of the ratings agencies (market regulated disclosures) and information made publicly available (Pillar 3).
  Ratings agencies know which information they want and have the bargaining power to obtain it.
  Market will progressively define which information has to be made public.
- CP 3 stipulates that the purpose of Pillar 3 – market discipline is to complement Pillar 1 and Pillar 2. [15]
- CP 3 stipulates that supervisors must take care to carry out their obligations in a highly transparent and accountable manner. The supervisors should make publicly available the criteria. [16]

Fortis Bank standpoint:

- Mandatory disclosures are only at top consolidated level.
- Banks should not have to disclose under Pillar 3 the supervisory review process or the conclusions made by supervisors for an individual bank.
- Banks should have to disclose neither the assessment on its own capital nor the review (and possibly imposed add-ons) by the supervisor under Pillar 2.

14. PILLAR 3 - DISCLOSURES

Issue:

- CP 3 reduces the disclosure requirements and takes better into account the proprietary information. But some disclosure requirements remain too prescriptive.

Fortis Bank standpoint:

[14] CP 3 - § 771
[15] CP 3 - § 758
[16] CP 3 - § 756

Technical information remains excessive. Some examples are:

- Disclosures [17] about PD, LGD, EAD and about back testing.
- Disclosures about insurance are inconsistent (deducted following Pillar 1) [18]
- Disclosures of the capital under BIA and STA when a bank has adopted AMA.

F. MACRO-ECONOMIC IMPACTS

15. PRO-CYCLICALITY

Issue:

- The new regulations will induce that, at unchanged credit portfolio, the point-in-time required regulatory capital will strongly fluctuate through the economic cycle. [19] A mechanical and a point-in-time alignment of the credit risk management on the available equity might induce banks to a "stop and go" attitude, lead to a contraction of credit activities by banks at times when they are most needed by the companies, and therefore amplify the economic cycle.
- Banks have currently a buffer between the shareholders equity and the minimum regulatory capital. With the new Basel Accord, this buffer will be more volatile. In order to avoid procyclical effects, supervisors and ratings agencies will possibly request a higher buffer to cover a higher volatility. This has not been taken into account in the QIS 3 calibration.
- Greater and swifter fluctuations in the risk profile of banks and their regulatory capital requirements might lead to greater volatility of their stock prices and therefore a higher return requirement, from investors. This phenomenon in turn could lead either to higher costs for banking services or force banks to reduce costs via a reduction of workforce, both with negative macro-economic consequences.
- Although most banks have currently excess capital compared to the minimum regulatory requirements, a general increase of this minimum level could force the banking industry to rise new capital with all its financial consequences for the banks' shareholders, clients and personnel. One should not forget that banks compete with all other companies on capital markets for equity and should be competitive in terms of return for investors.

Fortis Bank standpoint:

- Macroeconomics impacts of the new Basel Accord is the responsibility of national central banks.
- Cyclicality will be addressed in Pillar 1: It's the responsibility of banks to have risk-sensitive processes to manage credit risks, taking into account the business cycle. Supervisors should not systematically require add-ons in Pillar 2
  Diversification effects will be tackled through Pillar 2.
- Dynamic provisioning could offer a beginning of solution, but cannot be dissociated from the IAS issues. In this respect, three-part meeting between the Basel Committee, IASB and the banking industry is essential.

16. LEVEL PLAYING FIELD : SAME RULES FOR SAME RISKS

Issue:

- European banks will be submitted to capital requirements, to prescriptive risk management, to regulatory reporting and to mandatory disclosures. Some of their competitors will not be submitted to the same constraints, with as consequence unfair competition. For example: local US banks, cards companies, non-bank leasing or factoring companies, consumer's credits granted by non bank institutions, investments firms or services.

Fortis Bank standpoint:

Same banking operations and same risks should be submitted to same rules.

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[17] CP 3 – Pillar 3 – Table 6

[18] CP 3 – Pillar 3 – Table 1

[19] Bundesverband Deutscher Banken - « Potential Pro-cyclicality of the Basel 2 framework - Analysis and possible solutions" 30.05.03 : "A volatility of about 40% in regulatory capital would put a serious stress on the stability of any financial sector"

17. EQUITY FINANCE

Issue:

- Capital requirements resulting from the new approaches are rather high (notably in comparison with the current approach under Basel 1 or the standardised approach), especially for private equity and participations that are not listed on a recognised stock exchange. The several floors incorporated in the different IRB approaches causes an extra burden in capital requirements. The high new capital requirements represent a serious risk: withdrawal of banks of this business, unfair competition from entities not subject to Basel Accord, increased cost for SME & starters.
- The fact that diversification effects with other risk types (such as interest rate risk) are not included adds to this concern of high capital requirements for equity.

Fortis Bank standpoint:

- Basel Committee should pay attention to the macro-economic impacts of high capital requirements and find ways to lighten them, for instance by taking into consideration diversification effects and by removing some floors.

18. SECURITISATION

Issue:

The approach is excessively conservative. The complexity and lack of clarity of the provisions make the document understandable only to specialists. The severe potential sanctions could discourage current bank issuers or investors.
Examples of application of the rules should be helpful.

Fortis Bank standpoint:

- Basel Committee should not discourage securitisation as a diversification tool for risk management.

G. GENERAL

19. SIMPLIFIED, UNDERSTANDABLE AND FLEXIBLE TEXT

Issue:

- The CP 3 is a document of over 200 pages. It's could be perceived by non specialists as complex, excessively prescriptive, over-elaborated, not sufficiently in line with bank practices. A simplified and understandable text should increase awareness and acceptance.
- Organisational and systems adjustments needed in order to comply with the new regulatory requirements represent quite substantial investment for the banking industry, to be achieved during a relatively short period of time. Those investments are to the detriment of business or cost-cutting investments.
  Convergence between regulatory requirements and business needs should create support to implement the Basel Accord.
- The CP3 appears insufficiently flexible to evolve with a dynamic and changing banking industry.

Fortis Bank standpoint:

- The final document should be streamlined and simplified.
- Basel Accord (and the implementation at European or national level) should focus on principles and should avoid defining in detail the technical aspects.
  Banks should continue to develop and update their risk management policy, tools, systems and processes to meet first and foremost the needs of their business and not to comply with regulatory requirements. Banks should have the freedom to adopt new risk management methodologies, which better match their needs without having to wait for a legislative amendment.
- The several risk curves should continue to evolve to reflect the risks experienced by the banks. They should not be linked to the expected overall regulatory capital level and not be influenced by it.
- Even if at the beginning it will be the targeted level, the 8 % ratio should be allowed to fluctuate (upwards / downwards) in order to reflect the actual risks of the banking industry.

20. <u>TEMPORARY FLOORS</u>

<u>Issue:</u>
On top of the transitional minimum capital floors (90 & 80%) globalising credit, operational and market risks [20], CP 3 adds some specific floors such as LGD floor of 10% for retail exposures secured on residential property.

<u>Fortis Bank standpoint</u>:
Temporary floors should be limited to the minimum capital floors globalising credit, operational and market risks.

[20] CP 3 - § 23